



CITY OF SAN JOSE, CALIFORNIA

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February 5, 1988

Honorable Mayor and Members
of the City Council
801 North First Street, Room 600
San Jose, CA. 95110

This is a Report of *The Activities And Accomplishments Of The Office Of The City Auditor For The Period October 1, 1986 Through December 31, 1987*. It is the third such report that I have prepared. I will continue to issue similar reports on a regular basis as a means of demonstrating the Office's accountability to the City Council.

The 15 months that are covered in this report have been productive, challenging and rewarding. I am very grateful to the City Council for their support of this Office. We have improved considerably over the past two and one-half years, but further improvements are possible and necessary. I am looking forward to working with the City Council and the Administration to secure those improvements for the Office and ultimately for the City of San Jose.

I will present this report to the Finance Committee at its February 17, 1988 meeting. If you need any additional information, please let me know.

Respectfully submitted

Gerald A. Silva
City Auditor

EXSUM014
GS:mlt



*OFFICE OF THE
CITY AUDITOR*

**THE ACTIVITIES AND ACCOMPLISHMENTS
OF THE OFFICE OF CITY AUDITOR
OCTOBER 1, 1986 THROUGH DECEMBER 31, 1987**

*A REPORT TO THE
SAN JOSE
CITY COUNCIL*

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SUMMARY

This third report on the activities of the Office of the City Auditor covers the period from October 1, 1986 through December 31, 1987.

During this time period, the Office implemented a new auditing strategy and underwent its first Charter-required performance audit. In response to newly proposed auditing standards, the Office implemented an auditing strategy that focuses on risk assessment and evaluating the sufficiency and adequacy of the auditee's internal controls.

In addition, a management representative from the California Auditor General's Office conducted the first performance audit of the City Auditor's Office. This review resulted in an unqualified (clean) opinion of the Office's system of quality control, thereby providing assurance that our audits meet generally accepted governmental auditing standards.

During this time period, Office productivity remained high despite reduced budget and staff for most of 1987. Although a Senior Program Performance Auditor position was vacant during 1987 and Non-personal Expenditures were reduced by half, the Office still completed 11 fiscal/performance audits of City programs and activities, 8 informational studies, and 1 investment compliance review. These 20 reports contain 125

recommendations to improve operational effectiveness, efficiency and internal controls. Moreover, these reports identified over \$7.9 million in opportunities to either increase revenues or reduce costs. Beginning on page 36, Schedule 1 summarizes the Office's activity costs and results for the period of October 1, 1986 through December 31, 1987.

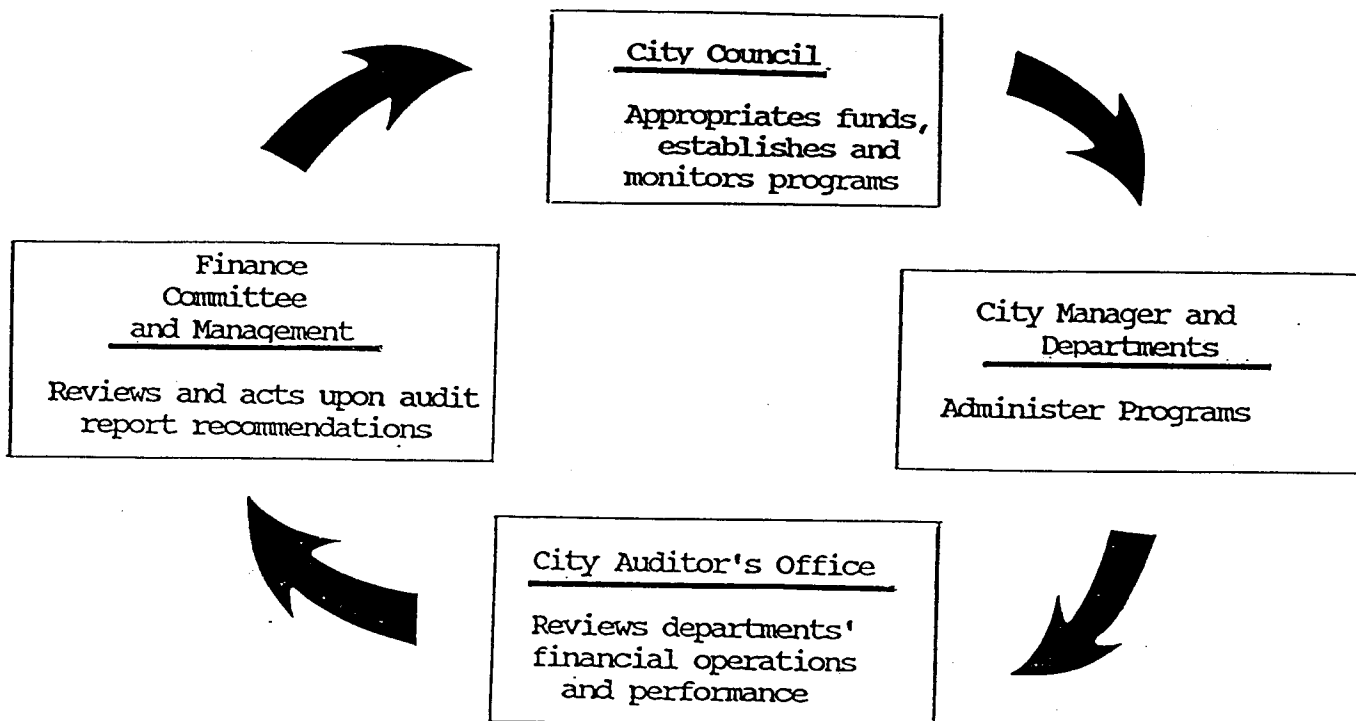
The 15 months that are chronicled in this report have been demanding and rewarding. Despite a declining budget, the Office continued to make good progress against its audit workplans. The City Council and the Administration have been very supportive of the Office and its critical role in city government. We will continue to strive to improve those relationships and to be even more responsive to the needs of the City Council and the people of the City of San Jose.

ROLE OF THE CITY AUDITOR'S OFFICE

The total capital and operating budget for the City of San Jose exceeds one billion dollars a year. As the size of the City government grows, so does the City Council's need for an effective means to monitor the use of tax dollars and City department activities and programs. An independent audit function is an integral part of that oversight process. Findings and recommendations developed through the audit process can help save tax dollars, increase revenues, and improve the management of City programs. Additionally, independent audits serve as an important information source for the City Council, City management and the general public.

The City Auditor is appointed by and reports to the City Council. The Finance Committee reviews and approves the City Auditor's annual audit workplan, subsequently reviews audit report findings and recommendations, and monitors the implementation of recommendations. However, the Rules Committee has the primary responsibility of approving City Council member or Administration requests for audit service as they arise during the year.

ROLE OF AUDITING IN CITY GOVERNMENT



Office of the City Auditor audits and reviews provide an insight into City departments and their programs. Such audits and reviews are but one step in the process of establishing City programs, evaluating their performance, providing the City Council and the Administration with needed information, and making any necessary changes to ensure that City programs are as effective as possible.

Section 805 of the San Jose City Charter established the Office of the City Auditor and outlined the Auditor's primary duties as follows:

- Conduct a post audit of all the City's fiscal transactions including the examination and analysis of fiscal procedures and the examination, checking and verification of accounts and expenditures;
- Submit a monthly report to the City Council of the Office activities, findings and recommendations to improve the administration of the City's fiscal affairs; and
- Perform other such auditing functions consistent with the Office's charter and submit reports as required.

In November 1986, the electorate of San Jose passed a far reaching ballot measure known as Measure J. While the Charter changes in Measure J were both numerous and profound, four of them pertain specifically to the Office of the City Auditor. Of these four changes, one provided that the City Auditor would conduct "performance audits" as assigned by the City Council. This auditing concept is described in greater detail in a later section.

ORGANIZATION AND STAFF

The City Auditor's Office has 19 authorized full-time positions including both audit and administrative staff. The Office's budget for 1987-88 is \$1.03 million. Due to a City-wide hiring freeze, one Senior Program/Performance Auditor position has been vacant for ten months.

The members of the City Auditor's Office have diverse educational backgrounds and work experience. Staff educational backgrounds include accounting, business administration, civil engineering, economics, education, finance, and public administration. Further, several staff members have advanced academic degrees or professional certificates. In addition, staff members have previous experience in public accounting, city government, public administration, aerospace, banking, data processing, electronics, management consulting, industrial relations, and retail. This wide range of training and experience helps bring a broad perspective to the variety of audit work the Office conducts.

Memberships in professional organizations include the American Institute of Certified Public Accountants, American Society for Public Administration, American Management Association, American Compensation Association, American Society of Personnel Administrators, EDP Auditors Association, Governmental Finance Officers Association, Institute of Internal Auditors, and the Western Intergovernmental Audit Forum.

In general, auditors work in teams of two or more depending on the workload and projected time frames of an assignment. Auditors are assigned to projects on the basis of the particular audit skills needed to perform the work. Typically, a fiscal and a performance auditor will work together on a team to ensure the team collectively possesses the professional proficiency required to accomplish the audit task.

A list of our staff members follows:

Professional Staff

Gerald A. Silva - CPA
Jeffrey L. Mikles - MPA

Kenneth M. Arimura - CPA (Pending)
Gerald N. Baiocchi
Nestor S. Baula - CPA, CIA
Juan E. Bettaglio - MBA
Rene E. Bulan
Fred B. Casuga
Charles D. Christensen, Jr. - CPA, CISA
Jan Heimann-Cook - MPA
Michael A. Edmonds - CIA
Ruth Garcia
Dominador S. Melendez - CPA (Pending)
Joseph S. Morical - M.A.
Taylor L. Willingham

Administrative Staff

Bonnie J. Leslie

Mary N. DaRosa
Minh Le Tran

RECENT DEVELOPMENTS IN THE
OFFICE OF THE CITY AUDITOR

Since the Office's last annual report in December 1986, the City Auditor's Office has implemented a new auditing strategy and undergone its first Charter-required performance audit. Both situations promise to improve the Office's operational effectiveness and efficiency.

New Auditing Strategy

During 1987, the AICPA Auditing Standards Board proposed nine new Statements of Auditing Standards which have been characterized by some as revolutionary for the audit profession. Of particular interest to this Office is the new statement addressing the auditor's responsibility for evaluating an entity's internal control structure. This statement requires the auditor to first obtain an understanding of the entity's overall control environment, and specific accounting and administrative controls. Next, the auditor must identify and test for potential threats (undesired events) that could occur if adequate controls are absent or ineffectively implemented. To effectively implement this audit strategy, the Office purchased a specialized software package called Riskbuster which assists the auditor in relating potential threats or risks to an entity's internal control system.

We believe the Office of the City Auditor is on the leading edge, relative to other audit organizations, regarding the use of risk assessment as an audit strategy.

Office Performance Audit

In June 1987, the Office underwent its first peer review performance audit. The City Charter requires such an audit be performed on a biennial basis. A management representative from the California Auditor General's Office performed the review according to standards established by the National State Auditors Association. This initial audit focused on the Office's formal written audit and office administration procedures and controls. The purpose of the audit was to determine if the procedures and controls provide reasonable assurance that City Auditor audits will meet the specified standards.

Following the audit, the Auditor General issued two letters (Appendix IV and V). The first letter expressed an overall unqualified (clean) opinion on the City Auditor's system of quality control. The second letter addressed opportunities to improve the Office's system of quality control, all of which have been implemented. As a result of the audit, we are confident that our audits meet generally accepted governmental auditing standards.

AUDITING CITY DEPARTMENTS AND PROGRAMS

The City Auditor's Office conducts expanded scope auditing in conformance to audit standards promulgated by the United States General Accounting Office (Appendix II). The three types of expanded scope auditing are financial and compliance audits, economy and efficiency audits, and program results audits. Economy and efficiency, and program results audits are commonly known as performance or operational audits. The Office also reviews EDP systems in accordance with U.S. General Accounting Office (GAO) audit standards and produces special reports that present objective information on issues.

Financial and Compliance Audits

In accordance with the City Charter, the annual audit of the City's financial statement is performed by an outside independent public accounting firm. This audit determines whether the financial statements fairly present the financial condition of the City in accordance with generally accepted accounting principles. The annual outside audit also includes reviews to determine City compliance with laws and regulations, particularly for those programs receiving federal funding.

The City Auditor's Office also conducts financial and compliance audits, but the nature and scope of these audits

differ significantly from the external audit of the City's financial statements. The primary emphasis of financial and compliance audits conducted by the Office is to assess whether the City's internal control systems ensure that:

- Resources are used in accordance with laws, regulations, and policies.
- Reliable data is obtained, maintained, and properly disclosed in financial and management reports.
- Resources are safeguarded against loss due to fraud, theft, errors, and mismanagement.

These audits provide City management with the objective information it needs to ensure that the internal control systems are working as intended.

Operational and Performance Audits

Operational and performance audits evaluate whether City programs are conducted in an efficient and economical manner and are accomplishing their intended objectives. Audits that focus on program efficiency typically evaluate the reasonableness of program costs relative to the results of services produced. Auditors determine if a program is utilizing its resources, such as personnel, property, and space, in a manner that avoids duplication of effort and overstaffing, while maximizing benefits in relation to costs. Reports make recommendations for management action to correct inefficient practices or to improve procedures in order to maximize resource utilization and productivity.

Other operational or performance audits review the effectiveness of programs in achieving desired levels of performance or results. These audits are termed program results or effectiveness audits. Major elements of a program results audit include determining if a program has established appropriate goals and objectives, reviewing the adequacy of management's system for measuring success, assessing the extent to which desired levels of results are achieved, and identifying factors that inhibit satisfactory performance. Audit reports that review the effectiveness of a program generally make recommendations to change management systems, City policies, and Ordinances.

Auditing EDP Systems

EDP or information system audits review 1) general and application controls and 2) City data processing systems. These audits determine whether controls are designed according to management and legal requirements and provide data that is timely, accurate, reliable and complete. EDP audits also assist management in ensuring that automated systems 1) contain built-in controls for proper operation, 2) provide a trail with which events can be tracked through the system, and 3) ensure accurate classification of data in City financial statements.

Special Reports

The City Auditor's Office frequently receives requests for information on issues that do not require detailed audit review but need thorough and impartial data collection, analysis and reporting. The Office produces special studies to address these information needs. Special studies and reports are subject to the same rigorous audit methodology regarding data collection and quality control reviews. Special studies are intended to provide timely and objective information to the City Council, the Administration, and the public.

Annual Workplan

In advance of each fiscal year, the City Auditor independently selects the audits to be performed in the forthcoming year and incorporates them into an Annual Workplan. Before formalizing the proposed workplan, the City Auditor receives input from the City Administration on areas needing audit and review. During May or June, the City Auditor submits his proposed workplan to the Rules Committee for approval.

In addition to Workplan audits, the City Auditor's Office conducts unscheduled audits as requested by City Council members or the City Manager. These requests are approved subject to the procedure shown in Appendix III.

Finally, the City Auditor reports Workplan progress monthly to the Finance Committee, City Council, and the City Administration.

BENEFITS TO THE CITY OF SAN JOSE

The City Auditor's expanded approach to audit work benefits the City in a variety of ways. Several of the audits contain recommendations to reduce costs or increase revenues. While other reports may not produce measurable monetary benefits, they do contain recommendations to increase effectiveness, use resources more efficiently, and improve internal controls. Other special studies provide objective information to the City Council, City Administration and the public. Beginning on page 36, Schedule 1 summarizes the results of City Auditor activities for the period October 1, 1986 through December 31, 1987.

Cost Savings and Increased Revenue

Audit work sometimes reveals that a Department's operations are not managed as efficiently and economically as possible. City Auditor findings and recommendations often address ways to save money or to increase revenues.

For example, the performance audit of the City's utility tax collection process revealed instances where the City failed to monitor the tax collection process. Finance did not collect overdue taxes and late payment charges, and invalid tax adjustments were allowed. As a result, we estimated that the City potentially lost approximately \$300,000 during 1985-86.

In addition, our audit of the City's retirement plans and the City and Redevelopment Agency's cash management activities disclosed opportunities to increase retirement fund earnings and reduce General Fund administrative and overhead costs. We found that if over the last five years the plan's equity portfolio had been invested in a passive index fund instead of with a variety of unsuccessful fund managers, the plans could have earned on the average about \$2.6 million more per year. Further, investment fees and administrative and overhead expenses could have also been reduced approximately \$549,000 a year.

In total, the audit reports covering this reporting period identified over \$7.9 million in opportunities to increase revenues and/or reduce costs.

Improve Effectiveness and Efficiency

Audit recommendations often address ways in which a department can improve the management of its operations by increasing its effectiveness and efficiency. Although the dollar value of improvements cannot be precisely measured, implementing changes have the potential for long-term benefits in improved services and programs.

For example, our performance audit of the Department of Parks and Recreation's maintenance activities revealed deficiencies in the Department's maintenance task analysis. Without effective task analysis, Department management could not objectively assess staffing requirements. We also identified the need for an improved facility evaluation process and better use of existing information to manage central services and control equipment usage.

In addition, our recent audit of the redevelopment site delivery process disclosed that the roles and responsibilities of the Redevelopment Agency and the Department of Neighborhood Preservation were not clearly defined. This resulted in diffused accountability, duplicated effort, and the dissemination of inaccurate and conflicting information to the public. We also found the need to implement a formal project management system to control the site delivery process in the most efficient manner possible.

Strengthen Controls

Audits also identify ways to improve departmental and program internal controls, safeguard assets, and reduce potential risk of liability to the City. Our audit of the Redevelopment Agency's 20% housing program revealed a pervasive absence of controls over the planning, monitoring and loan

approval processes as well as over its financial operations. The program lacked specific plans and adequate procedures to accomplish its housing goals. In addition, the Agency lacked both sufficient information to properly evaluate loan proposals and controls over document preparation. Moreover, important documentation was not properly safeguarded against loss.

In addition, our controls review of the City's automated checkwriter system disclosed that certain controls were either missing entirely, incomplete, or not performed at the most effective time. We also found the need to document and conduct a controls review of the City's accounts payable system, and provide additional controls over labor error expense accounts.

Providing Objective Information

Audit reports and special studies can provide reliable, objective and timely information to decision-makers and the public. This information can assist the Council and Departments in making needed policy and administrative changes, and help educate the public about the management of its City government. Our report regarding fine arts funding provided valuable information to the Council and the Administration about the allocation of Transient Occupancy Tax funds to the Convention and Visitors Bureau, cultural groups, and the Convention and Cultural Facilities Department.

SUMMARY OF WORK PERFORMED
(October 1986 - December 1987)

From October 1986 through December 1987, the City Auditor's Office completed 11 fiscal/performance audits of City programs and activities, 8 informational studies, and 1 investment compliance review. A narrative summary of these reports follows. In addition, an activity cost and results summary is provided on Schedule 1 beginning on page 36.

FISCAL/PERFORMANCE AUDIT REPORTS

City's Capital Budget Administration (November 1986)

Our review of the City's administration of the Capital Budget revealed that central management capability was lacking and that the Capital Budget significantly overstated the City's ability to complete capital projects. Specifically, we found that there was no central authority that actively monitored and managed the implementation of the Capital Budget. Further, our analysis of 1984-85 capital expenditures showed the following:

- Less than half of the \$356.5 million budgeted for the 1984-85 Capital Improvement Program was spent or committed.
- Less than two-thirds of the \$45.5 million budgeted for capital projects that were rebudgeted from 1983-84 was spent or committed.
- Only 42 percent of the \$227.8 million budgeted for multi-year projects was spent or committed.
- Only 40 percent of the \$35.5 million budgeted for new one-year capital projects was spent or committed.
- Less than 20 percent of the \$10.9 million budgeted for mid-year additions to the 1984-85 Capital Budget was spent or committed.

As a result, the Capital Budget was viewed as creating unrealistic expectations in the minds of the City Council, City officials, and the citizens of San Jose.

We recommended that the City Manager establish a central Capital Budget management capability, improve cost and reporting controls, and include in the Capital Budget only those projects that the City can realistically accommodate.

Parks and Recreation's Maintenance
Activities (December 1986)

Our review revealed that the Department could improve maintenance activities in several ways. For example, we found that deficiencies in the Department's task frequency analysis impaired management's ability to accurately assess maintenance staffing needs. Analysis charts did not reflect actual park conditions and were replete with errors. In addition, the Department's facility evaluation lacked objectivity and did not allow for systematic identification of park deficiencies. Evaluation criteria and procedures needed to be established. Further, the Department needed to better use existing information to improve its ability to manage central services activities and to control equipment usage. As a result, the Department was not effectively and efficiently using its resources.

We recommended that the Department revise and automate its task frequency analysis process, use management staff to perform formal facility evaluations, develop a facility deficiency data base, and better use control logs for management information purposes.

City's Utility Tax Collection Process (March 1987)

Our audit revealed instances where the City failed to collect utility taxes that were due, allowed invalid utility tax adjustments, and did not collect the required interest charges on late utility tax remittances. Due to insufficient monitoring of tax receipts, Finance failed to collect interest and penalties on late tax payments. In addition, Finance had been late in notifying the utility companies of new property annexations and the utility companies had been late in applying the tax. Further, Finance needed to improve its controls over the utility tax exemption process. As a result of these deficiencies, we estimated that the City potentially lost approximately \$300,000 during 1985-86.

We recommended that the Municipal Code be amended concerning the receipt and application of tax payments, and that the penalty provisions of the Code be enforced. In addition, we recommended that Finance establish a tax receipt monitoring procedure, initiate collection of invalid or overstated tax adjustments, and develop tax exemption controls.

Redevelopment Agency's 20% Housing Program (June 1987)

Our audit revealed that the Redevelopment Agency needed to improve the Housing Program planning process, implement adequate and sufficient loan process and accounting controls, and establish a borrower monitoring program. The Agency had not

sufficiently assessed the housing needs of low and moderate income people in San Jose, or developed adequate plans, procedures and budgets to accomplish the program's goals. In addition, the Agency had not instituted adequate or sufficient controls over the housing loan process or financial records. Further, the Agency was not monitoring borrowers to ensure that they were complying with all the terms of their loan agreements. As a result, there was no assurance that available funds and assets were properly safeguarded and effectively used.

We recommended that the Agency assign higher priority to the housing program, establish a formal housing needs assessment process with plans and budgets, develop written procedures and forms to analyze and approve housing proposals and loans, and monitor borrowers. In addition, we recommended that the Agency establish written accounting policies and procedures and provide appropriate training to staff.

Non-Personal Expenditures for FY 1985-86 (June 1987)

Our audit revealed that the value of lost discounts and overpayments decreased significantly from those of the prior year because of improved accuracy of payment voucher preparation and review. However, lost discounts continued to result from City department delays in processing documentation on goods and services received. The audit also disclosed that

the number of late payments significantly increased and some late charges were paid. Further, we found a limited number of isolated internal control exceptions which were not systemic deficiencies. As a result, overall performance in this area has improved but additional improvements could be made.

We recommended several internal control changes to improve operational effectiveness and efficiency.

*City and Redevelopment Agency
Investment Program (June 1987)*

Our audit disclosed several approaches which could enhance portfolio yields without creating undue risk. Accordingly, we found that the City has foregone between \$1.4 and \$2.8 million per year in potential earnings by maintaining a more conservative investment position than risk or liquidity considerations require. In addition, the audit revealed that the current investment policy limited Treasury's ability to manage the City and Agency portfolios. Further, we determined that merging the City and Agency portfolios would increase earnings. As a result, investment management and results could be improved.

We recommended the development of a strategy to extend the average portfolio maturities, investment policy changes, and the merging of the City and Agency portfolios.

City's Checkwriter System (July 1987)

Our review of the controls over the City's automated checkwriter system was expanded to also include a limited review of the accounts payable system. We found that the checkwriter controls needed improvement, the accounts payable system needed to be documented and reviewed for controls and efficiency, and that labor error suspense accounts needed supervision. Specifically, the audit disclosed that certain checkwriter controls were either missing entirely, were incomplete, or were not performed at the most effective time. In addition, we determined that the accounts payable system lacked appropriate segregation of duties and desk instructions, and that systems documentation was inadequate. Further, the audit revealed that charges in the labor error suspense accounts remained uncorrected for long periods of time and that some charges were made twice. As a result, adequate and appropriate controls needed to be implemented to ensure the integrity and safety of the City's financial systems.

We recommended the implementation of 19 internal controls to prevent, detect and correct errors. These included controlling access to data files, reconciling check stock and use logs, properly segregating duties, issuing desktop instructions, documenting the accounts payable system and reviewing it for controls and efficiency, and monitoring labor error suspense account balances.

Information Systems' Contingency Plan (November 1987)

This audit was limited to evaluating the contingency plans for critical electronic data processing (EDP) activities performed by the Information Systems Department. Due to the Department's response to our initial inquiries, we determined that the existing plan needed to be updated. Since the Department agreed to update the plan by March 1988, we terminated our review and issued this report. Specifically, we found that the Department operates three types of computer facilities, but that only one type of facility has a written contingency plan. Moreover, that one plan needs to be updated and other critical EDP activities performed in the city need to be included in the plan. As a result, the City is exposed to the risk that critical EDP activities may be lost to the City for periods of time that exceed tolerable limits.

We recommended that all critical EDP applications in the City be identified and that contingency plans be prepared by March 1988.

City's Retirement Plans and the City
and Redevelopment Agency's Cash Management
Activities (December 1987)

Our review revealed the following:

- Opportunities existed to significantly increase retirement fund earnings and reduce administrative costs.

- By charging the retirement plans for services provided by the Personnel Department, the General Fund would save about \$229,000 per year.
- The abilities of the City's investment officials are impaired because of unreliable cash flow information.
- The Agency lost interest income by maintaining bank balances in excess of the required compensating bank balance.
- Agency cash forecasting needed to be improved.
- The Agency needed to obtain surplus funds for the bond trustee on a timely basis.
- The Finance Department needed to improve its interdepartmental coordination and monitoring of bond trustee investments.

Specifically, we found that if over the last five years the retirement plans' equity portfolio had been invested in an equity index fund, the plans could have earned about \$13 million more. Also, investment management fees could have been reduced by about \$1.5 million over the same time period. In addition, the City's General Fund could have saved about \$229,000 a year by charging the plans for their pro rata share of Personnel Department staff, space and materials. Further, the City's cash forecasting data are inaccurate, thereby reducing forecasting effectiveness.

We also found that the Agency lost the opportunity to earn \$70,000 in investment income over a 19-month period by maintaining excessive bank balances. Furthermore, due to the Agency's ineffective cash forecasting methods, we estimated

that the Agency lost interest earnings of \$500,000 to \$800,000 annually. Moreover, our review revealed that the Agency was slow to secure over \$14 million in surplus funds from the bond trustee which could have been used to increase the Agency's portfolio earnings.

We recommended that the Retirement Plan Boards consider using passive management for a portion of their equity portfolio and that the plans absorb their share of the administrative costs. In addition, we recommended that the City and Agency improve their cash forecasting accuracy, and that the Agency establish procedures to obtain surplus funds from the bond trustee in a timely manner.

Redevelopment Site Delivery Process (December 1987)

The Redevelopment Agency and the Department of Neighborhood Preservation jointly administer the site delivery process. Our audit revealed that the Agency and the Department needed to clearly define their respective roles and responsibilities in the site delivery process. This is because they have duplicated each other's efforts, provided the public with confusing and conflicting information, and failed to effectively control rental property. In addition, the Department needed to develop a formal project management system to effectively and efficiently relocate displaced residents as a result of site delivery

activities. Due to these conditions, there were numerous opportunities to improve the site delivery and resident relocation process.

We recommended that the Agency and the Department jointly develop a written memorandum of understanding to define their respective roles on future site delivery projects. In addition, we recommended that formal rent control policies and procedures be developed, a project management system for planning and monitoring future projects be established, and that relocation records requirements be formulated. Finally, we recommended that staff receive training on relocation procedures and the pertinent laws and regulations relating to the site delivery process.

The Agency's Capital Improvement Program (December 1987)

Our audit revealed that opportunities existed to enhance the Redevelopment Agency Board's ability to assess the status of the Redevelopment Capital Program. The Agency had not developed quantifiable goals and objectives for each redevelopment area and the Agency's capital program progress reports did not provide a clear status of the program. In addition, the Agency needed to improve its financial accountability over the Capital Budget. We found that many of the budgeted projects had not been started and funds had not been encumbered or spent

as planned. Further, the funds were being controlled at the project area level and not at the project level as budgeted. As a result, Capital Program progress was difficult to measure accurately and public spending expectations were not being met.

We recommended that the Agency develop definitive and quantifiable goals and objectives for each project area and prepare a work program to accomplish them. In addition, we recommended various budgeting and reporting controls to provide more accurate and timely information to the Agency Board.

INFORMATIONAL STUDIES

A Review of Consulting Contracts Awarded During Calendar Years 1984 and 1985 (December 1986)

In response to a City Council directive, the City Auditor compiled selective information on consulting contracts over \$20,000 for the two-year period. The study's primary focus was on those contracts which required the preparation and submission of a tangible product such as a report, study or plan. We did not attempt to evaluate contractor performance.

Our study revealed that during 1984 and 1985, the City Council approved 224 consulting contracts, or addendums to contracts, with a value of at least \$20,000. The total stated value of the contracts was \$37,475,904. Of the 224 contracts, 129 or 58 percent were for services. The stated value of the service contracts was \$19,735,502. The remaining 95 contracts required the contractor to deliver a tangible product. The stated value of these contracts was \$17,740,402.

Of the 95 contracts that required the production of a tangible product, 70 resulted in the delivery of such a product. For the remaining 25 contracts, 20 were still in progress, 2 were on hold, and 3 were terminated.

Of the 21 reports produced, 15 contained 208 recommendations, of which 129 or 60 percent were fully implemented. Departments reported that of the remaining recommendations, 55 were still in progress, 12 were on hold, and 12 were rejected for various reasons.

We recommended that the City Council consider imposing followup reporting requirements for future consulting contracts.

Quarterly Followup Report on Audit Recommendations (Class 1 and 2 only) as of October 31, 1986 (December 1986)

This report summarized the implementation status of 32 audit recommendations made to the Finance Department for the three months ended October 31, 1986. The report shows that of 32 recommendations made: 8 were implemented, 9 were partly implemented, 12 were unimplemented, and 3 were deferred until a verifiable transaction occurred.

An Addendum to a Review of Consulting Contracts Awarded During Calendar Years 1984 and 1985 (February 1987)

As an addendum to our December 1986 review, we compiled a listing of the consulting contracts of \$20,000 or more approved by the Redevelopment Agency Board during the subject years. Our study revealed that during the two-year period, the Board approved 32 such consulting contracts, or addendums to contracts, with a total stated value of \$5,965,758. Of these contracts, 11 or 34 percent were for services. The total

stated value of the service contracts was \$4,355,500 or 73 percent of the total stated value of all the approved consulting contracts for the two-year period. The remaining 21 contracts required the contractor to deliver a tangible product. The stated value of these contracts was \$1,610,258 or 27 percent of the total stated values of all the consulting contracts approved during 1984 and 1985.

Of the 21 tangible-product contracts, 20 resulted in the delivery of the specified product. The other contract was still in progress. Of the 20 products received, 19 were reports, 12 of which contained 59 recommendations. Almost 80 percent (47) of the recommendations were fully implemented, 11 were still in the process of implementation, and one was rejected.

We recommended that the Board consider imposing followup reporting requirements for future consulting contracts.

Quarterly Followup Report on Audit Recommendations
(Class 1,2 &3) as of January 31, 1987 (March 1987)

This report summarized the implementation status of 76 audit recommendations made to the City Manager's Office, Finance Department, General Services Department, and the Parks and Recreation Department for the three months ended January 31, 1987. The report shows the following results:

	<u>Implemented</u>	<u>Partly Implemented</u>	<u>Not Implemented</u>
City Manager (5)	0	4	1
Finance (36)	17	15	4
General Services (19)	10	2	7
Parks & Recreation (16*)	0	0	0

* All recommendations were class 3 which allows the Department one year to implement.

Fine Arts Funding Study (May 1987)

In response to a City Council directive, the City Auditor reviewed the allocation of Transient Occupancy Tax (TOT) funds to various fund recipients, including the Fine Arts Division of the Convention and Cultural Facilities Department. Our review revealed that by using a full accrual accounting method for budget purposes, recipient funding levels could be maintained, \$359,500 could be returned to the General Fund, and money could be left in the TOT fund as a reserve. In addition, we found that past allocations were made according to the ordinance-prescribed formula, but differences resulted. Further, the use of the ordinance-prescribed 12 percent cap restriction affected the allocation process. Moreover, we noted that the cultural groups had contributed significant funding from their allocations to support the Fine Arts Division.

We recommended that the Administration use a full accrual accounting method for TOT Fund budget purposes, and that the City Council amend City Code Section 4.72.060 to provide that the TOT Fund allocations to all recipients be based upon the estimated revenues for the budget year.

Quarterly Followup Report on Audit Recommendations
(Class 1 and 2 only) as of April 30, 1987 (July 1987)

This report summarizes the implementation status of 31 audit recommendations made to the Finance Department for the three months ended April 30, 1987. The report shows that of the 31 recommendations made: 9 were implemented, 7 were partly implemented, 14 were unimplemented, and 1 was dropped.

Quarterly Followup Report on Audit Recommendations
(Class 1, 2 & 3) as of July 31, 1987 (October 1987)

This report summarizes the implementation status of 103 audit recommendations made to seven City departments/offices for the three months ended July 31, 1987. The report shows the following results:

	<u>Implemented</u>	<u>Partly Implemented</u>	<u>Not Implemented</u>
Finance (41)	15	12	14
Redevelopment Agency (26)	7	13	6
Parks & Recreation (16)	5	0	11
General Services (9)	3	1	5
City Manager (8)	5	3	0
Information Systems (2)	1	0	1
Traffic Operations (1)	1	0	0

Quarterly Followup Report on Audit Recommendations (Class
1 and 2 only) as of October 31, 1987 (December 1987)

This report summarizes the implementation status of 38 audit recommendations made to the Finance Department, Redevelopment Agency, Traffic Operations Department, and the City Manager's Office for the three months ended October 31, 1987. The report shows the following results:

	<u>Implemented</u>	<u>Partly Implemented</u>	<u>Not Implemented</u>
Finance (22)	3	7	12
Redevelopment Agency (13)	9	4	0
Traffic Operations (2)	1	0	1
City Manager (1)	0	1	0

INVESTMENT COMPLIANCE REVIEW

Review of December 1986, January and
July 1987 Transactions (December 1987)

As the eighth in a series of investment reviews, this review revealed that Finance has generally complied with investment policy requirements. However, we did note one exception relative to under-collateralizing a Redevelopment Agency repurchase agreement. Noncompliance continued in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition and executing formal master repurchase and safekeeping agreements.

In addition, this report contains the results of our follow-up on the implementation of prior compliance recommendations. Of the 30 recommendations made over the last two years, we found that 24 had been fully implemented, with the balance in the process of being implemented.

SCHEDULE I

OFFICE OF THE CITY AUDITOR

Summary of Activity Costs and Results
For the Period October 1, 1986 Through December 31, 1987

<u>Reports Issued</u>	<u>Estimated Audit Cost</u>	<u>Identified Opportunities to Increase Revenues/ Reduce Costs</u>	<u>Number of Recommendations to Improve Efficiency/ Effectiveness (1) / (2)</u>	<u>Number of Recommendations to Strengthen Internal Controls (1) / (2)</u>	<u>Informational</u>
A Performance Audit of the City's Capital Budget Administration	\$ 24,788		(3) / (2)	(3) / (2)	
A Performance Audit of the Department of Parks and Recreation's Maintenance Activities	19,619		(9) / (0)	(7) / (5)	
Quarterly Follow-up on Audit Recommendations as of 10/31/86	5,731				X
A Review of Consulting Contracts Awarded During Calendar Years 1984 and 1985	26,660			(1) / (0)	X
An Addendum to the Review of Consulting Contracts				(1) / (0)	X
A Performance Audit of the City's Utility Tax Collection Process	37,222	\$ 302,488	(6) / (0)	(6) / (0)	
Quarterly Follow-up on Audit Recommendations as of 1/31/87	5,731				X
An Audit of the City and Redevel- opment Agency Investment Program (includes study by PMM & Co.)	188,416	4,076,000	(4) / (3)		
An Audit of the City's Non- Personal Expenditures for Fiscal Year 1985-86	44,031	60,013		(3) / (1)	
An Audit of the Redevelopment Agency's 20% Housing Program	167,819		(5) / (0)	(21)/(16)	

(1) Recommended

(2) Implemented as of 10/31/87

SCHEDULE I

OFFICE OF THE CITY AUDITOR

Summary of Activity Costs and Results
For the Period October 1, 1986 Through December 31, 1987

<u>Reports Issued</u>	<u>Estimated Audit Cost</u>	<u>Identified Opportunities to Increase Revenues/ Reduce Costs</u>	<u>Number of Recommendations to Improve Efficiency/ Effectiveness (1) / (2)</u>	<u>Number of Recommendations to Strengthen Internal Controls (1) / (2)</u>	<u>Informational</u>
Fine Arts Funding Study	\$ 8,936	359,500		(2) / (0)	X
A Controls Review of the City's Checkwriter System	26,942			(19)/(13)	
Quarterly Follow-up on Audit Recommendations as of 4/30/87	5,731				X
A Control Review of Information Systems Contingency Plan	7,075			(2) / (0)	
Quarterly Follow-up on Audit Recommendations as of 7/31/87	5,731				X
A Compliance Review of the City's Investment Activities*	46,072			(1) / (0)	
A Review of the City's Retirement Plans and the City and Redevel- opment Agency's Cash Management Activities*	44,747	3,149,000	(3) / (0)	(5) / (0)	
The Audit of the Site Delivery Process of Redevelopment*	201,002		(4) / (0)	(10)/(0)	
The Agency's Capital Improvement Program*	146,419			(13)/(0)	
Quarterly Follow-up on Audit Recommendations as of 10/31/87	<u>5,731</u>	<u> </u>	<u> </u>	<u> </u>	X
SUBTOTAL	<u>\$1,018,404</u>	<u>\$7,947,000</u>	<u>(34)/ (5)</u>	<u>(91)/(37)</u>	

(1) Recommended

(2) Implemented as of 10/31/87

(*) These reports were released in early January 1988, however, for the purpose of this report, we are showing these audits as completed by December 31, 1987.

S C H E D U L E I

OFFICE OF THE CITY AUDITOR

Summary of Activity Costs and Results
For the Period October 1, 1986 Through December 31, 1987

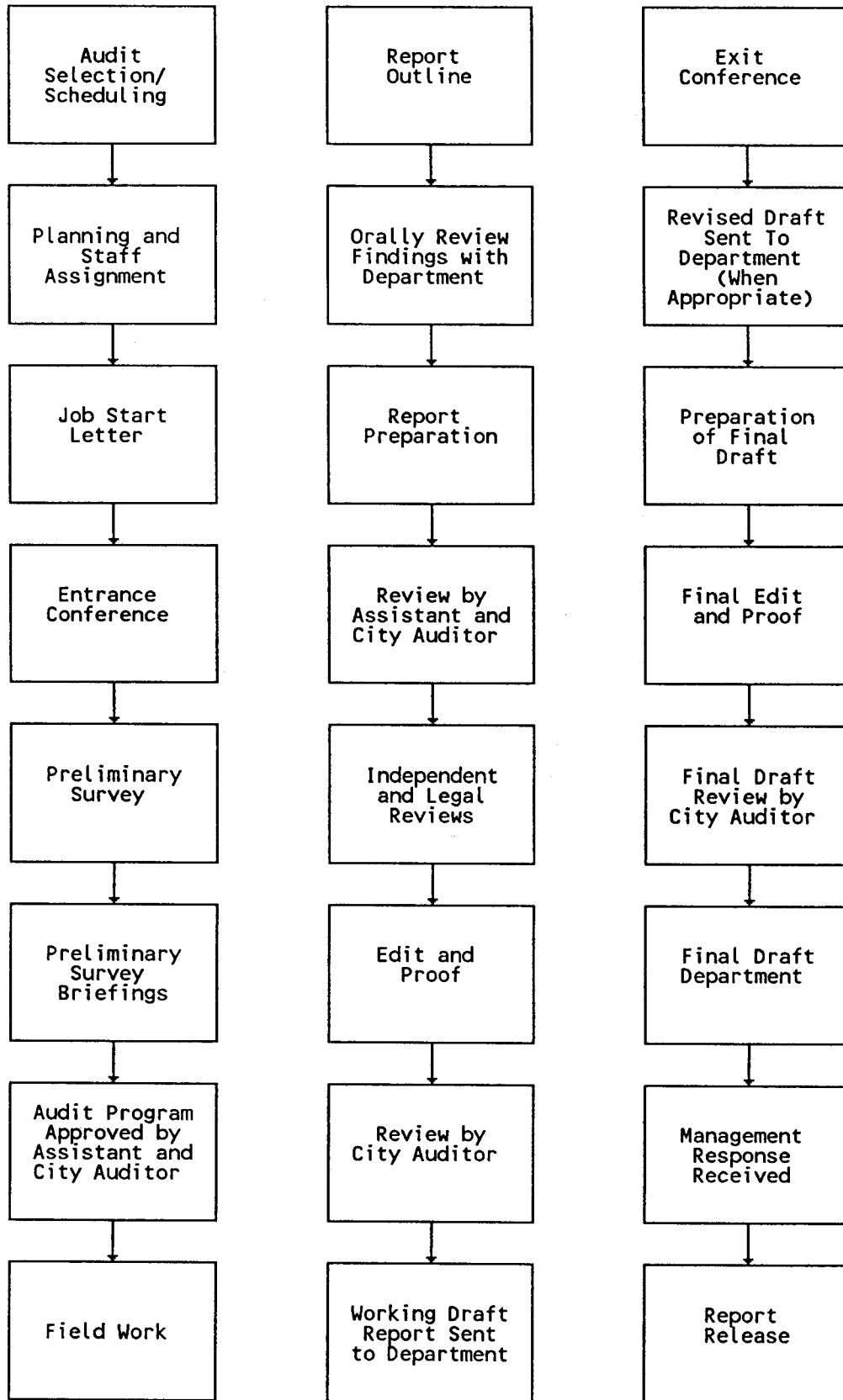
<u>Assignments in Progress</u>	<u>Estimated Audit Cost</u>	<u>Identified Opportunities to Increase Revenues/ Reduce Costs</u>	<u>Number of Recommendations to Improve Efficiency/ Effectiveness (1) / (2)</u>	<u>Number of Recommendations to Strengthen Internal Controls (1) / (2)</u>	<u>Informational</u>
Payroll Audit	\$ 77,884				
Cash and Revenue Audit	29,654				
Special Assessment District Financing	33,110				
Airport Parking	45,345				
Audit of Vertical Management Systems	33,490				
Contracted City Services Review	12,544				
Airport Department Performance Audit	3,357				
Assistance to Outside Auditors	<u>16,151</u>				
SUBTOTAL	\$ 251,535				
Other	<u>20,109</u>				
TOTALS	<u>\$1,290,048</u>	<u>\$7,947,000</u>	<u>(34)/ (5)</u>	<u>(91)/27)</u>	

(1) Recommended

(2) Implemented as of 10/31/87

AUDIT PROCESS CHRONOLOGY

APPENDIX I



APPENDIX II

STANDARDS FOR AUDIT OF
GOVERNMENTAL ORGANIZATIONS, PROGRAMS,
ACTIVITIES, AND FUNCTIONS

SUMMARY OF STANDARDS

A. Scope of Audit Work

The expanded scope of auditing a government organization, a program, an activity, or a function should include:

1. Financial and compliance - determines a) whether the financial statements of an audited entity present fairly the financial position and the results of financial operations in accordance with generally accepted accounting principles and b) whether the entity has complied with laws and regulations that may have a material effect upon the financial statements.
2. Economy and efficiency - determines a) whether the entity is managing and utilizing its resources (such as personnel, property, space) economically and efficiently, b) the causes of inefficiencies or uneconomical practices, and c) whether the entity has complied with laws and regulations concerning matters of economy and efficiency.
3. Program results - determines a) whether the desired results or benefits established by the legislature or other authorizing body are being achieved and b) whether the agency has considered alternatives that might yield desired results at a lower cost.

In determining the scope for a particular audit, responsible audit and entity officials should consider the needs of the potential users of audit findings.

B. General Standards

1. Qualifications: The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
2. Independence: In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, must be free from personal or external impairments to independence, must be organizationally independent, and shall maintain an independent attitude and appearance.
3. Due professional care: Due professional care is to be used in conducting the audit and in preparing related reports.
4. Scope impairments: When factors external to the audit organization and the auditor restrict the audit or interfere with the auditor's ability to form objective opinions and conclusions, the auditor should attempt to remove the limitation or, failing that, report the limitation.

C. Examining and Evaluation (Field Work) and Reporting Standards for Financial and Compliance Audits

1. AICPA Statements on Auditing Standards for field work and reporting are adopted and incorporated in this statement for government financial and compliance audits. Future statements should be adopted and incorporated, unless GAO excludes them by formal announcement.
2. Additional standards and requirements for government financial and compliance audits.
 - a. Standards on examination and evaluation:
 1. Planning shall include consideration of the requirements of all levels of government.
 2. A review is to be made of compliance with applicable laws and regulations.
 3. A written record of the auditors' work shall be retained in the form of working papers.

4. Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts and if such evidence exists, extend audit steps and procedures to identify the effect on the entity's financial statements.

b. Standards on reporting:

1. Written audit reports are to be submitted to the appropriate officials of the organization audited and to the appropriate officials of the organizations requiring or arranging for the audits unless legal restrictions or ethical considerations prevent it. Copies of the report should also be sent to other officials who may be responsible for taking action and to others authorized to receive such reports. Unless restricted by law or regulation, copies should be made available for public inspection.
2. A statement in the auditors' report that the examination was made in accordance with generally accepted government auditing standards for financial and compliance audits will be acceptable language to indicate that the audit was made in accordance with these standards. (See Chapter V, Paragraph 2b for AICPA-suggested language).
3. Either the auditors' report on the entity's financial statements or a separate report shall contain a statement of positive assurance on those items of compliance tested and negative assurance on those items not tested. It shall also include material instances of noncompliance and instances or indications of fraud, abuse, or illegal acts found during or in connection with the audit.
4. The auditors shall report on their study and evaluation of internal accounting controls made as part of the financial and compliance audit. They shall identify as a minimum:
 - a) the entity's significant internal accounting controls, b) the controls identified that were evaluated, c) the controls identified that were not evaluated (the auditor may satisfy this requirement by identifying any significant classes of

transactions and related assets not included in the study and evaluation), and d) the material weaknesses identified as a result of the evaluation.

5. Either the auditors' report on the entity's financial statements or a separate report shall contain any other material deficiency findings identified during the audit not covered in (3) above.
6. If certain information is prohibited from general disclosure, the report shall state the nature of the information omitted and the requirement that makes the omission necessary.

D. Examination and Evaluation Standards for Economy and Efficiency Audits and Program Result Audits

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.
3. A review is to be made of compliance with applicable laws and regulations.
4. During the audit a study and evaluation shall be made of the internal control system (administrative controls) applicable to the organization, program, activity, or function under audit.
5. When audits involve computer-based systems, the auditors shall:
 - a. Review general controls in data processing systems to determine whether 1) the controls have been designed according to management direction and known legal requirements and 2) the controls are operating effectively to provide reliability of, and security over, the data being processed.
 - b. Review application controls of installed data processing applications upon which the auditor is relying to assess their reliability in processing data in a timely, accurate, and complete manner.

6. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditors' judgments and conclusions regarding the organization, program, activity, or function under audit. A written record of the auditors' work shall be retained in the form of working papers.

7. The auditors shall:

a. Be alert to situations or transactions that could be indicative of fraud, abuse, and illegal acts.

b. If such evidence exists, extend audit steps and procedures to identify the effect on the entity's operations and programs.

E. Reporting Standards for Economy and Efficiency Audits and Program Results Audits

1. Written audit reports are to be prepared giving the results of each government audit.

2. Written audit reports are to be submitted to the appropriate officials of the organization audited and to the appropriate officials of the organizations requiring or arranging for the audits unless legal restrictions or ethical considerations prevent it. Copies of the reports should also be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies should be made available for public inspection.

3. Reports are to be issued on or before the dates specified by law, regulation, or other special arrangement. Reports are to be issued promptly so as to make the information available for timely use by management and by legislative officials.

4. The report shall include:

a. A description of the scope and objectives of the audit.

b. A statement that the audit (economy and efficiency or program results) was made in accordance with generally accepted government auditing standards.

- c. A description of material weaknesses found in the internal control system (administrative controls)
 - d. A statement of positive assurance on those items of compliance-tested and negative assurance on those items not tested. This should include significant instances of noncompliance and instances of or indications of fraud, abuse, or illegal acts found during or in connection with the audit. However, fraud, abuse, or illegal acts normally should be covered in a separate report, thus permitting the overall report to be released to the public.
 - e. Recommendations for actions to improve problem areas noted in the audit and to improve operations. The underlying causes of problems reported should be included to assist in implementing corrective actions.
 - f. Pertinent views of responsible officials of the organization, program, activity, or function audited concerning the auditors' findings, conclusions, and recommendations. When possible, their views should be obtained in writing.
 - g. A description of noteworthy accomplishments, particularly when management improvements in one area may be applicable elsewhere.
 - h. A listing of any issues and questions needing further study and consideration.
 - i. A statement as to whether any pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated. If a separate report was issued containing this information it should be indicated in the report.
5. The report shall:
- a. Present factual data accurately and fairly. Include only information, findings, and conclusions that are adequately supported by sufficient evidence in the auditors' working papers to demonstrate or prove the bases for the matters reported and their correctness and reasonableness

- b. Present findings and conclusions in a convincing manner.
- c. Be objective.
- d. Be written in language as clear and simple as the subject matter permits.
- e. Be concise but, at the same time, clear enough to be understood by users.
- f. Present factual data completely to fully inform the users.
- g. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in a balance perspective considering any unusual difficulties or circumstances faced by the operating officials concerned.

APPENDIX III

PROCEDURE FOR OBTAINING CITY COUNCIL APPROVAL OF REQUESTED CITY AUDITOR ASSSIGNMENTS

- I. City Council members or the City Manager submit requests for City Auditor services to the *Rules Committee*.
 - A. Any specific information or areas to be reviewed should be identified in the request.
- II. The *Rules Committee* will forward the request to the City Auditor.
- III. The City Auditor will review the request and respond back to the *Rules Committee* at it's next meeting regarding the following factors.
 - The availability of audit staff and resources.
 - Any external time constraints relative to the requested assignment.
 - Other factors the City Auditor deems important.
- IV. At its next meeting the *Rules Committee* will
 1. Review the City Auditor's response,
 2. Approve or disapprove the requested assignment and
 3. Communicate its decision to the City Auditor, the City Council and the assignment requestor
- V. Upon *Rules Committee* approval of an audit assignment, the City Auditor will initiate the assignment as soon as staff become available.
- VI. The City Auditor will report monthly to the *Rules Committee and Finance Committee* the status of approved audit assignments.
- VII. The City Auditor may respond immediately to requests from the City Manager, City Attorney or City Clerk for services when the request indicates an emergency situation exists. The City Auditor will report to the *Rules Committee* at its next meeting:
 - Any requests for immediate response received.
 - What action was taken.
 - The disposition of the request.



Telephone:
(916) 445-0255

STATE OF CALIFORNIA
Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

September 24, 1987

Mr. Gerald A. Silva
City Auditor
151 W. Mission Street, Room 109
San Jose, California 95110

Dear Mr. Silva:

We have reviewed the system of quality control in effect as of June 30, 1987, for audits issued by the City Auditor for the City of San Jose and have issued a separate management letter thereon dated September 23, 1987. As specified in our engagement letter dated April 6, 1987, our review was limited to an assessment of personnel and audit administration procedures and controls to ensure conformity with the standards specified in the National State Auditors Association's (NSAA) "Quality Review Guidance for Government Audit Organizations." Since your quality control procedures were not implemented until April 1, 1987, we did not conduct substantive testing of the implementation of the quality control procedures.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in the guidelines issued by the NSAA. Such a system should be sufficiently comprehensive and designed to ensure production of reliable audits given the audit organization's structure, legal requirements, policies, and the nature of its functions.

In our opinion, the system of quality control for the City Auditor of the City of San Jose in effect as of June 30, 1987, met the objectives of the quality control guidelines issued by the NSAA. Furthermore, in our opinion, the office of the City Auditor's adherence to its system of internal controls should provide reasonable assurance that the office's work will conform to professional standards.

Sincerely,


THOMAS W. HAYES
Auditor General

RECEIVED
OCT 5 1987



Telephone:
(916) 445-0255

STATE OF CALIFORNIA
Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

September 24, 1987

Mr. Gerald A. Silva
City Auditor
151 W. Mission Street, Room 109
San Jose, California 95110

Dear Mr. Silva:

We have reviewed the system of quality control for audits issued by the City Auditor for the City of San Jose in effect as of June 30, 1987, and have issued a separate report dated September 24, 1987, on our review of that system. This letter should be read in conjunction with that report.

During our review, we did not note any material weaknesses that we believe are essential for an adequate system of quality control. However, we noted a few areas where you could enhance your existing system of quality control to provide a more efficient implementation of the audit process.

BACKGROUND

The City Auditor for the City of San Jose is responsible for providing performance audits, financial audits, and special studies. Under the present organizational structure, the staff of the City Auditor conducts performance audits and special studies. The City Auditor serves as the contracting agent to procure the required financial audit services and procures special study services that require specialized or unique skills or experience. Our review was limited to evaluating the City Auditor's system of quality control in place as of June 30, 1987, for conformance with the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the Comptroller General of the United States.

We have performed our review of your system of quality control in accordance with the scope outlined in our engagement letter dated April 6, 1987. Since your quality control procedures were not implemented until April 1, 1987, we did not conduct substantive testing of the implementation of the quality control procedures. To assess the quality control policies and procedures, we used the "Quality Review Guidance for Government Audit Organizations" recommended by the National State Auditors Association. Mr. Thomas A. Britting, Audit Manager, with the Office of the Auditor General, conducted the actual review. Mr. Britting has extensive performance audit experience with both the United States General Accounting Office and the Office of the Auditor General of the State of California.

Mr. Gerald A. Silva
City Auditor
September 24, 1987
Page 2

RECOMMENDATIONS

The following recommendations are made to enhance the City Auditor's existing system of quality control to provide for a more efficient implementation of the audit process.

1. The City Auditor procures financial audits under contract with certified public accounting firms. The contracts presently used by the City Auditor clearly outline the contractors' audit responsibilities and the professional standards that the contractors must follow. The contracts are prepared by the City Attorney with consultation from the City Auditor. Under current procedures, prior year contracts serve as a model for subsequent year contracts. Although the City Auditor has followed this procedure, the procedure is not clearly stated in the Operations Manual. The City Auditor has recognized the need for improving procedures in this area and was working on developing procedures for financial audit standards during the course of our review. Therefore, we recommend that the City Auditor complete the development of procedures that a contractor must follow to ensure adherence to professional standards and incorporate these procedures into the Operations Manual.
2. The City Auditor requires the audit staff to provide assurances that they meet the standards of independence at the beginning of each engagement. However, during an engagement, situations may arise that may impede the auditor's independence. To allow for such situations, Generally Accepted Government Auditing Standards place responsibility on the individual auditor to inform management if such an event takes place. The City Auditor's existing procedures are silent on this issue. Therefore, we recommend that the City Auditor add to the Operations Manual a procedure placing responsibility on the audit staff for informing management of any events that may call into question the auditor's independence.
3. The City Auditor's procedures adequately address the standards of evidence required of governmental auditors. One of those standards requires that an auditor seek corroboration of testimonial evidence when the auditor must rely on statements made by the auditee to support critical elements of an audit finding. At times, we have experienced situations where no corroborative evidence exists and reliance on interviews could

Mr. Gerald A. Silva
City Auditor
September 24, 1987
Page 3

lead to disputes because of the potential for miscommunication. To enhance the reliability of testimonial evidence, we recommend that the City Auditor adopt a procedure requiring audit staff to obtain letters of representation from auditees when the auditors must rely on uncorroborated testimonial evidence.

4. Generally Accepted Government Auditing Standards require audit organizations to maintain a training program that maintains and enhances the auditing skills of professional staff. The City Auditor adequately addresses this standard by annually evaluating the specific training needs of each auditor and obtaining the necessary training within the budget constraints for training. Recent recommended draft revisions to government auditing standards would specify a minimum of 80 hours of continuing professional education each two years with at least 24 hours in government-related auditing subjects. Should this revision be adopted, we recommend the the City auditor make provision to provide the required level of training prescribed by the standards.

This management letter is intended solely for the use of the City Auditor for the City of San Jose and should not be used for any other purpose except at the discretion of the City Auditor. We appreciate the cooperation and assistance extended by the management and staff of the City Auditor.

Sincerely,


THOMAS W. HAYES
Auditor General



GERALD A. SILVA
City Auditor

CITY OF SAN JOSÉ, CALIFORNIA

151 W. MISSION STREET, ROOM 109
SAN JOSE, CALIFORNIA 95110
(408) 277-4601

September 28, 1987

Mr. Thomas W. Hayes
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you, Mr. Kurt Sjoberg, and Mr. Tom Britting, for conducting this Office's first peer review performance audit. As you know, City Charter Section 805.2 requires that a performance audit of the City Auditor's Office be conducted and reported to the full City Council just before the mid-point and conclusion of the City Auditor's four-year appointment. Because your review was in accordance with the standards specified in the National State Auditors Association's "Quality Review Guidance for Government Audit Organizations," this Office was able to meet its statutory requirement.

I was very impressed with Mr. Britting's professional approach and thoroughness. His guidance and recommendations will enhance our quality control system and better prepare us for future peer reviews. Your recommendations are appropriate and we are taking the following steps to implement them:

1. Procurement of outside financial audit services:

Our operating procedures 4-07, "Contracting for Services," provides for the contracting of outside professional services. However, it does not specifically address the procurement of financial audit services or provide the required audit contract boilerplate. Both of these elements will be included in the revised procedure.

2. Standards of independence:

Our operating procedure 4-01, "Job Number and Staff Assignment," addresses the identification of auditor impairments at the job assignment phase of each audit. It will be revised to also require staff to advise management during the audit should an impairment develop that might

Mr. Thomas W. Hayes
Office of the Auditor General
Re: Peer Review - Office of the
City Auditor
September 28, 1987

Page 2

impede the auditor's independence. All audit staff have already been informed of their responsibility to report any situations that may arise during an assignment that may impair their independence.

3. Standards of evidence:

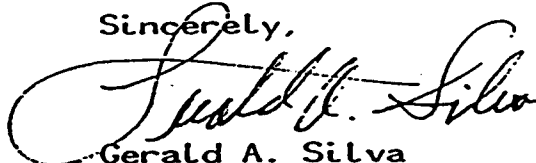
Our operating procedure attachment 5-05.1, "Rules of Evidence," addresses the use and risk of using interviews as evidence. Although this Office uses letters of representation, they have not been specified in policy. We will revise attachment 5-05.1 to address this shortcoming.

4. Continuing professional education hours:

Our operating procedure 2-04, "Staff Training/ Continuing Education," provides for training for all staff. We are aware of the proposed standard for auditors of 80 continuing education hours every two years with at least 24 hours in government-related auditing subjects. Should the GAO adopt the standard, we will revise our procedure accordingly.

Again, Jeff Mikles and I sincerely appreciate your timely assistance in this very important matter and are pleased with the results of your review.

Sincerely,



Gerald A. Silva
City Auditor

GS:b